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Client Alert

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International: Fourth Set of Administrative Guidance for Pillar Two: More Guidance, More Complexity

In brief

On 17 June 2024, the OECD/G20 Inclusive Framework on BEPS ("**Inclusive Framework**") released a fourth tranche of technical guidance (the "**June 2024 Guidance**") on the implementation of the Global anti-Base Erosion Model Rules ("**GloBE Rules**"), which were originally approved and released by the Inclusive Framework on 20 December 2021. The June 2024 Guidance addresses the recapture of deferred tax liabilities ("**DTLs**"), deferred tax considerations relating to differences in GloBE and accounting carrying values, the allocation of current and deferred taxes to PEs and CFCs, the allocation of profits and taxes in certain hybrid situations, and the proper treatment of securitization vehicles.

The Inclusive Framework members have agreed that jurisdictions that implement the GloBE Rules will "*subject to any requirements of domestic law, apply the GloBE Rules in accordance with any Agreed Administrative Guidance.*" See GloBE Rules, Article 8.3.1. The stated objective of the administrative guidance that the Inclusive Framework releases is to "*ensure consistent and common interpretation of the GloBE Rules, provide certainty for MNE Groups and facilitate coordinated and transparent outcomes under the rules.*" See June 2024 Guidance, Executive Summary, para 4.

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Before issuing the June 2024 Guidance, the Inclusive Framework had already released three tranches of guidance in February, July, and December of 2023.

Also on 17 June 2024, the Inclusive Framework released a concise Question & Answer document outlining plans for peer review to assess the qualified status of an implementing jurisdiction's Income Inclusion Rule ("**IIR**"), Undertaxed Profits Rule ("**UTPR**"), and Qualified Domestic Minimum Top-up Tax ("**QDMTT**"), as well as determine the jurisdiction's eligibility for the QDMTT Safe Harbor.

We summarize the key points in the June 2024 Guidance and peer review Q&A below.

Summary of the Key Points in the June 2024 Guidance

1. DTL Recapture

Generally speaking, Article 4.4.4 of the GloBE Rules requires the recapture of a DTL that is not reversed by the end of the fifth fiscal year following the fiscal year in which it is taken into account. This rule means that a Constituent Entity could recognize and treat that DTL as an increase in Covered Taxes in the year of accrual, and to the extent not reversed within five years, that Constituent Entity would be forced to re-calculate and treat the DTL as a reduction to Covered Taxes in the year of recapture. Specific exceptions to this recapture rule apply to DTLs that qualify as so called "recapture exception accruals", which include several common temporary differences that are not expected to be prone to taxpayer manipulation (e.g., depreciation of tangible property, R&D costs, etc.).

Since generally accepted accounting principles do not require companies to recapture DTLs, the GloBE Rules require multinational enterprises ("**MNEs**") to track and measure DTLs solely for GloBE purposes, thereby adding a significant compliance burden. Furthermore, many MNEs do not track DTLs at the asset level in their accounting systems and may not readily have access to the data needed to apply the DTL recapture rule on an asset by asset basis.

To address the practical application of the Article 4.4.4 recapture rule, the June 2024 Guidance outlines acceptable methodologies to track DTLs, including the ability to aggregate certain DTLs related to multiple general ledger accounts, and determine the amount subject to recapture.

The June 2024 Guidance provides three possible methodologies for tracking GloBE DTLs, namely: (i) item-by-item, where DTLs related to each single asset or liability are tracked individually; (ii) by “General ledger account” ("**GL account**"), where DTLs related to all the assets or liabilities in a GL account are grouped; and (iii) by “Aggregate DTL Category", where DTLs in relation to two or more GL accounts are tracked in the aggregate (e.g., where multiple GL accounts roll up to a single balance sheet account). This type of aggregation is more consistent with the practices of MNEs in tracking DTLs for financial accounting purposes and is intended to reduce their administrative burden. However, there are a number of limitations, including required separate tracking of unamortizable goodwill and intangibles, long lived intangibles, and related party receivables and payables. Additionally, GL accounts which create DTAs cannot be aggregated with GL accounts which create DTLs.

For financial accounting purposes, the aggregate deferred tax expense or benefit associated with the establishment and reversal DTLs are generally measured based on the difference in beginning of the year and end of the year balances and not tracked to individual assets. The June 2024 Guidance provides the methodologies a MNE group may use to determine the timing of reversal and amount subject to recapture for each DTL category. For a DTL category that consists only of short-term DTLs that are expected to reverse in five years, no tracking is required. The MNE group has to establish that all DTLs in the category are expected to reverse within that time frame based on the factual nature of the items, and should maintain supporting documentation. For other categories, the MNE group may apply a FIFO (generally considered to be more favorable) or LIFO approach. The June 2024 Guidance outlines the conditions and rules for the application of either methodology.

The June 2024 Guidance also clarifies that the "Unclaimed Accrual election" (per article 4.4.7 of the OECD Model Rules) could be extended to Aggregated DTL categories which are not expected to reverse within five fiscal years. In short, if the Unclaimed Accrual election applies for an Aggregated DTL category, an entity would not claim the accrual of the DTLs (and therefore no recapture should apply). That is, the DTL recapture mechanism does not apply to an increase in a DTL where a taxpayer has elected to treat that amount as an "Unclaimed Accrual" (i.e., an accrual that is not included in the Adjusted Covered Taxes) under Article 4.4.7. See June 2024 Guidance, section 2, para 49.

2. Divergences Between GloBE and Accounting Carrying Values

The GloBE Rules adjust Covered Taxes by an amount that is termed the "Total Deferred Tax Adjustment Amount." See GloBE Rules, Art. 4.1.1. As the June 2024 Guidance acknowledges, the starting point for the Total Deferred Tax Adjustment Amount is a Constituent Entity's financial accounts. See June 2024 Guidance, section 2, para. 4. In a number of key cases, however, the GloBE Rules require MNE groups to use values that differ from the accounting carrying values that the groups would otherwise use based on their accounting standards. A common example involves a cross-border asset transfer. While an accounting standard might require the transferee to maintain the transferor's carrying value in respect of the assets in question, Articles 3.2.3 and 6.3.1 of the GloBE Rules require the parties to use fair market value to determine both gain recognition and carrying value. It therefore follows that deferred tax assets ("**DTA**s") and DTLs that relate to transactions such as the above are likely to differ if they are based on the accounting carrying value or the GloBE carrying value.

The June 2024 Guidance therefore states that MNE groups must compute DTAs and DTLs based on the GloBE carrying value as opposed to the accounting carrying value, to the extent the two differ. See June 2024 Guidance, section 2, paras. 7 – 8. The relevant accounting standard nevertheless continues to determine both whether a DTA/DTL is recognized in the first place and to govern the accounting treatment of that DTA/DTL.

The June 2024 Guidance proposes to add to the Commentary on the GloBE Rules a simple example to illustrate the application of the rule. See June 2024 Guidance, section 2, para. 31 (new Commentary paras. 104.2 et seq.). In the example, Entity A in jurisdiction A transfers an asset to Entity B in jurisdiction B, which has a corporate income tax rate of 20%. The asset has a carrying value of 50 for Entity A and a fair market value of 150. The transfer is recorded at cost (50) for accounting purposes, and Entity B records a DTA of 20 (i.e., the difference between cost and fair market value of 100, multiplied by the jurisdiction B tax rate of 20%). Under the GloBE Rules, however, Entity B would not necessarily record a DTA or DTL at all. Pursuant to Article 3.2.3, Entity B would obtain a carrying value equal to the asset's fair market value, and, if the accounting amortization schedule aligns the with the jurisdiction B tax amortization schedule, there would be no (GloBE) book – tax difference for deferred tax accounting to address.

The June 2024 Guidance helpfully acknowledges that Chapters 1 – 8 of the GloBE Rules apply only with respect to items that arise when a Constituent Entity is subject to the GloBE Rules. See June 2024 Guidance, section 2, paras. 12, 15. Therefore, as a general rule, MNE groups should use accounting carrying values for deferred tax purposes with respect to items arising in years prior to the first year a jurisdiction comes within the scope of the Globe Rules (including during the Transitional Safe Harbor period).

There are several significant exceptions to this rule. The first is the exception to Article 9.1.1 in Article 6.2.1(c), which turns off pushdown accounting adjustments except in relation to certain transactions that occurred before 1 December 2021. In addition, Article 9.1.3 overrides a change in carrying value under the relevant accounting standard in respect of transactions after 30 November 2021 and instead requires the transferee to use the transferor's carrying value. Therefore, generally speaking, DTAs and DTLs with respect to Article 6.2.1(c) and Article 9.1.3 transactions follow the carrying values as adjusted by the GloBE Rules, notwithstanding the general mandate that the Chapters 1 – 8 do not apply until a jurisdiction becomes subject to those rules.

It therefore follows that, as a general rule, any DTAs/DTLs that would reflect an increase in carrying value as a result of an Article 9.1.3 transaction are effectively disregarded for GloBE purposes. See June 2024 Guidance, section. 2, para. 49. Nevertheless, if the transferor pays tax in connection with an Article 9.1.3 transfer, the June 2024 Guidance permits the transferee to recognize a DTA in respect of the tax, regardless of whether the relevant accounting standard would permit the transferee to recognize the DTA, and also provides that the DTA does not reduce the transferee's Covered Taxes. See June 2024 Guidance, section 2, para. 50.

As a coda to the above, we note that the June 2024 Guidance also addresses the carrying value of assets for purposes of the Substance-based Income Exclusion (i.e., the substance carve out that reduces the amount of profit to which GloBE top-up tax is applied). The June 2024 Guidance establishes that MNE groups use the carrying values in the Consolidated Financial Statements of the Ultimate Parent Entity, without regard to the adjustments detailed above. See June 2024 Guidance, section 2, para. 27.

3. Allocation of Cross-Border Current Taxes

Section 3 of the June 2024 Guidance focuses on the rules for allocating current taxes from a Main Entity to one or more PEs. The impetus for this guidance is the Inclusive Framework's recognition that tax regimes may blend PE income and allow for the cross-crediting of PE taxes against Main Entity tax on that income (perhaps within certain income categories). See June 2024 Guidance, section 3, para. 10. The objective of the June 2024 Guidance on this subject is to properly match Covered Taxes to the GloBE Income with respect to which they were accrued. While the guidance focuses on allocating taxes to PEs, the guidance also applies to tax in respect of income from CFCs, Hybrid Entities, and Reverse Hybrid Entities. See, e.g., June 2024 Guidance, section 3, para. 50.

The June 2024 Guidance sets forth a four-step methodology for allocating Main Entity taxes:

Step 1: As a first step, the MNE group determines the Main Entity's total net foreign source income – i.e., income from sources outside the Main Entity's jurisdiction. See June 2024 Guidance, section 3, para. 12. This income may include PE income, but may also include income of CFCs, Hybrid Entities, or Reverse Hybrid Entities and income such as royalties, dividends, and interest. See June 2024 Guidance, section 3, para. 11. As the examples in the June 2024 Guidance makes clear, this step involves both quantifying total foreign source income and identifying the origin of the income by entity/payor.

Step 2: As a second step, the MNE group determines the Main Entity's allocable Covered Taxes by taking the Main Entity's total current tax expense and subtracting tax on domestic source income and Blended CFC Taxes. Tax on domestic source income is excluded from allocable Covered Taxes because only tax on foreign source income is allocable. Blended CFC Taxes are excluded from allocable Covered Taxes because those taxes are allocated separately pursuant to paras. 58.1 – 58.7 of the Commentary to Article 4.3.2. CFC taxes that arise under non-Blended CFC Tax Regimes are nevertheless included in allocable Covered Taxes. For US parented groups, the guidance is therefore likely to be most relevant in relation to providing rules for allocating taxes in respect of subpart F income. That is because subpart F is not a Blended CFC Tax Regime since it has an applicable rate that is greater than 15% (see GloBE Rules, Commentary, Art. 4, para. 58.2), and therefore ostensibly qualifies as a CFC regime to which the June 2024 Guidance applies.

The GloBE Rules contain a number of adjustments when calculating Covered Taxes for the purposes of determining ETR, and a number of these adjustments must also be taken into account when calculating the allocable Covered Taxes for these purposes. For example, Qualified Refundable Tax Credits ("**QRTCs**") are treated as an increase in the domestic source income of the Main Entity. This increase is likely to result in adjustments to both the total current tax expense and the hypothetical domestic tax liability. Moreover, where the relevant Main Entity tax regime applies progressive tax rates (i.e., different tax rates depending on the amount of income earned), the difference in rates is taken into account.

Step 3: As a third step, the MNE group develops allocation keys for PEs, relevant CFCs, and the Main Entity. These allocation keys look at the taxable income of the relevant entity multiplied by the applicable tax rate (i.e., the Main Entity rate), less creditable foreign taxes that are accrued with respect to the relevant income. See June 2024 Guidance, section 3, para. 22.

Step 4: As a fourth step, the MNE group allocates taxes by multiplying the Main Entity's allocable Covered Taxes by a fraction that is represented by each allocation key over the sum of all allocation keys. See June 2024 Guidance, section 3, para. 29. The idea behind the allocation keys is to allocate Covered Taxes based on a combination of income and rate. If a PE has a lot of income and a very low tax rate, then it is reasonable to conclude that a good portion of the Main Entity's tax on foreign source income is properly allocable to the PE.

The June 2024 Guidance extends the basic methodology set forth above to situations in which a parent receives one or more taxable distributions, or in which the relevant Main Entity/parent jurisdiction "baskets" income in which cross-crediting is allowed. See June 2024 Guidance, section 3, paras. 34 et seq. & 41 et seq. For instance, the June 2024 Guidance provides that Covered Taxes with respect to a given basket are allocated based on allocation keys for that basket – an approach that ought to ensure that taxes on a basket of income are only allocated to Constituent Entities from which that income stems. See, e.g., June 2024 Guidance, section 3, para. 43.

Importantly, the June 2024 Guidance clarifies that only positive Covered Taxes are allocable to PEs, CFCs, Hybrid Entities, and Reverse Hybrid Entities. See June 2024 Guidance, section 3, para. 18. Therefore, the allocation of cross-border current taxes ought not to result in negative tax expense be allocated from the Main Entity/parent to PEs, CFC, Hybrid Entities, or Reverse Hybrid Entities.

4. Allocation of Cross-Border Deferred Taxes

One of the most anticipated aspects of the June 2024 Guidance is the guidance on allocating cross-border deferred taxes. As noted above, Covered Taxes include deferred taxes. Article 4.3.2 addresses the allocation of Covered Taxes from one Constituent Entity to another. It therefore follows that Covered Taxes that are allocable from a parent to a CFC include deferred taxes. The June 2024 Guidance generally confirms this point in section 4 as a whole. As an exception to this rule, the June 2024 Guidance nevertheless appears to foreclose the allocation of deferred taxes in relation to Blended CFC Tax Regimes (e.g., GILTI). *See* June 2024 Guidance, section 4, para. 24. The June 2024 Guidance justifies this position on the grounds that accounting standards may not require, or even allow, MNE groups to calculate deferred tax in respect of Blended CFC Tax Regimes. Thus, the June 2024 Guidance limits the allocation of Covered Taxes in relation to Blended CFC Tax Regimes to current taxes. To the extent this limitation impacts MNE groups adversely, or the justification that the Inclusive Framework provides is unfounded, engagement with the Inclusive Framework on this front would be warranted.

The June 2024 Guidance sets forth a five-step methodology for allocating deferred taxes to CFCs as well as to PEs, Hybrid Entities, and Reverse Hybrid Entities. See June 2024 Guidance, section 4, para. 28 et seq. & para. 45.

Step 1: The MNE group separates out the deferred taxes relating to the assets and liabilities of each CFC and splits them into three categories ((a) non-GloBE Income, (b) non-Passive GloBE Income, and (c) Passive GloBE Income) with taxes in category allocated to the CFC separately under the steps below.

Step 2: The MNE group calculates the pre-foreign tax credit deferred tax and creditable foreign taxes expected to be paid by the CFC which would give rise to foreign tax credits available to offset the pre-foreign tax credit expense (the "**Relevant Creditable Foreign Taxes**").

Step 3: The MNE group allocates the deferred tax with respect to non-GloBE Income to the CFC. This amount is then excluded from Covered Taxes under Article 4.4.1(a) with the result that this deferred tax expense is not taken into account by either the parent or the CFC.

Step 4: The MNE group allocates deferred tax with respect to non-Passive GloBE Income to the CFC entirely (unless a Five-Year Election, noted below, has been made). The CFC must then recast its pre-foreign tax credit deferred CFC tax liability to 15%.

Step 5: The MNE group allocates deferred tax with respect to Passive GloBE Income to the CFC. Pursuant to Article 4.3.3, the June 2024 Guidance limits the allocation of deferred tax in respect of Passive GloBE Income to the amount that would raise Covered Taxes on that income to 15%. See June 2024 Guidance, section 4, para. 41. Any deferred tax in respect of Passive GloBE Income in excess of this amount remains with the parent.

As an alternative to the above steps, an MNE group may instead make an election (which applies with respect to the parent jurisdiction) whereby all deferred taxes relating to CFCs, PEs, and hybrid entities are excluded. This is, and is termed, a "Five-Year Election." See June 2024 Guidance, section 4, para. 43.

5. Allocation of Profits and Taxes in Structures Including Flow-through Entities

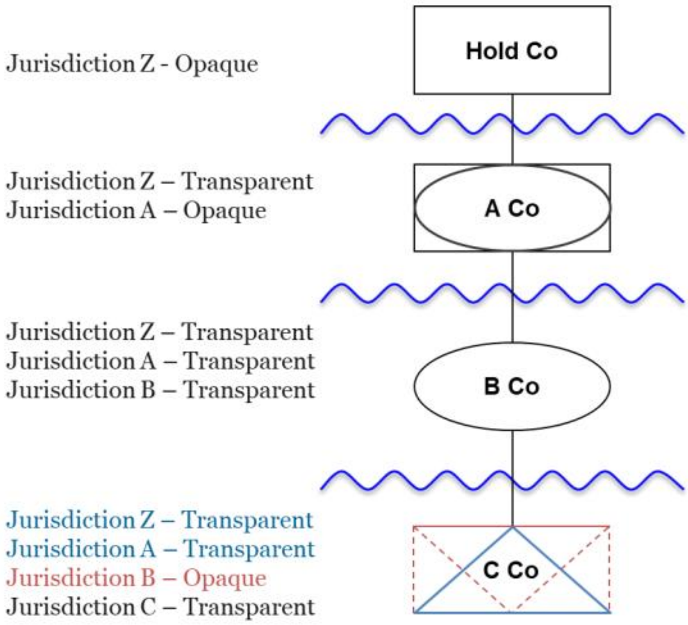
The June 2024 Guidance addresses the allocation of profits and taxes between Constituent Entities in structures where different jurisdictions take different views as to whether entities in the structures are fiscally transparent. In respect of Flow-through Entities, the Inclusive Framework strives to follow the core principle of GloBE and tries to match the tax with the income that has been subject to the tax.

The June 2024 Guidance addresses the following main issues:

1. **Treatment of a Flow-through Entity in more complex structures**

   For the purposes of GloBE Rules, a Flow-through Entity can either be treated as a Tax Transparent Entity (in which case its profits will be allocated to its owner) or a Reverse Hybrid Entity (in which case its profits are allocated to the Flow-through Entity itself). The status of the Flow-through Entity is normally determined based on how the Flow-through Entity is treated in the jurisdiction in which its direct owner is located. However, to avoid ambiguity and misallocation of profits, the June 2024 Guidance clarifies that the status of a Flow-through Entity should be determined by reference to the tax law of the Constituent Entity-owner closest to the Flow-through Entity in the ownership chain that is not itself a Flow-through Entity (the so-called "Reference Entity").

   The June 2024 Guidance includes a number of examples, including the following (see June 2024 Guidance, section 5, para. 29 et seq.):

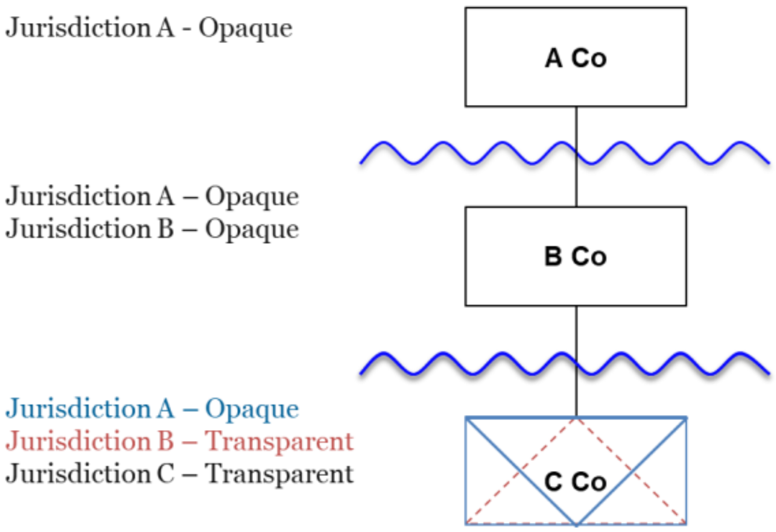


   In this example, the tax law of Hold Co's jurisdiction treats the three other Entities as fiscally transparent, but both Hold Co and A Co are subject to tax on C Co's income. The question is therefore which entity should be allocated C Co's profit under the GloBE rules. The June 2024 Guidance concludes that C Co's profits should be allocated to A Co because it is the "closest" entity to C Co in the ownership chain that is not itself a Flow-through entity (i.e., it isn't fiscally transparent in its own jurisdiction). Moreover, A Co is a Hybrid Entity because Jurisdiction Z views A Co as fiscally transparent. As a result, any taxes that Hold Co pays on C Co's profits are reallocated to A Co.

2. **Allocating cross-border taxes in more complex structures involving Flow-through Entities**

   Where profits of a Tax Transparent Entity are allocated to a Constituent Entity-owner under applicable provisions of the GloBE Rules, any Covered Taxes accrued by the Tax Transparent Entity with respect to this income should also be allocated to the Constituent Entity-owner. However, the GloBE Rules refer only to Covered Taxes that are 'accrued' in the Tax Transparent Entity's financial accounts that are used to compute its Financial Accounting Net Income or Loss but do not expressly mention any Covered Taxes that are 'reallocated' from another Constituent Entity (for example a CFC charge). The June 2024 Guidance clarifies that taxes reallocated to a Tax Transparent Entity should then be allocated in the same way as Covered Taxes accrued by the Tax Transparent Entity (i.e., resulting in all Covered Taxes being ultimately allocated to the same Constituent Entity to which the Financial Accounting Net Income or Loss is allocated under the GloBE Rules).

   The June 2024 Guidance provides the following example (see June 2024 Guidance, section 5, para. 60 et seq.) under which A Co applies its CFC regime to C Co (because Jurisdiction A views C Co as opaque) and asks whether that CFC charge should be allocated to B Co along with the income of C Co:

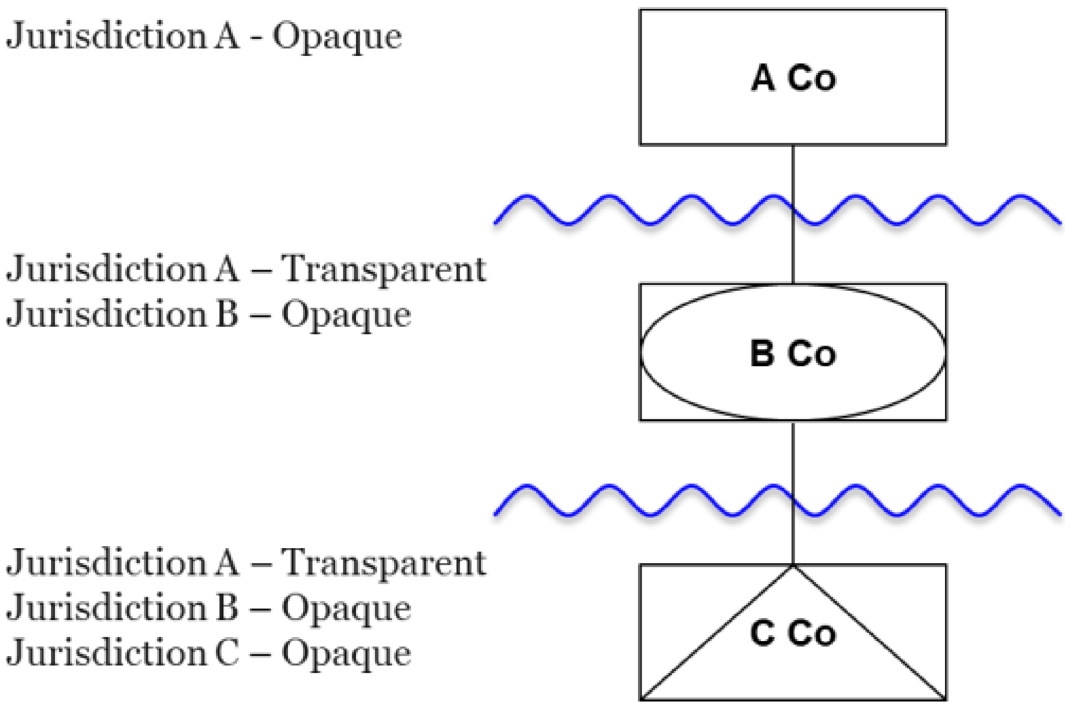


The June 2024 Guidance concludes that taxes allocated to a Tax Transparent Entity under Article 4.3.2 should be allocated in the same way as Covered Taxes accrued by the Tax Transparent Entity. That is, the tax will follow the allocation of the income. Accordingly, in this example, A Co's CFC charge should therefore be allocated to B Co.

3. **Allocating taxes of indirect owners to Hybrid Entities**

The June 2024 Guidance clarifies that Covered Taxes reflected in the financial accounts of the direct and indirect Constituent Entity-owners that relate to the income of the Hybrid Entity which are imposed because the entity is fiscally transparent under the tax law applicable to the direct and indirect Constituent Entity-owners will be allocated to the Hybrid Entity.

The June 2024 Guidance provides the following example (see June 2024 Guidance, section 5, para. 75 et seq.):



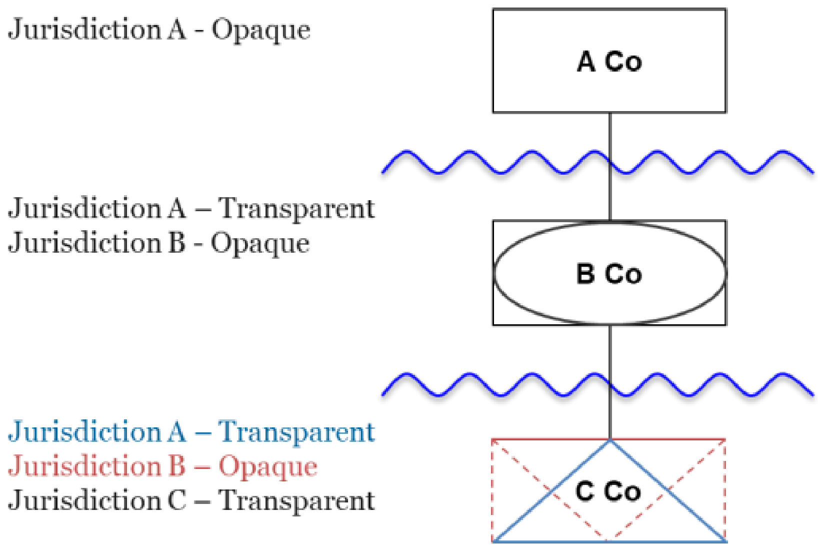
Because Jurisdiction B's tax laws do not treat C Co as transparent, C Co will not meet the Hybrid Entity definition with respect to B Co. If the reference to "owner" in Article 10.2.5 (the definition of Hybrid Entity) is limited to the direct owner, then the taxes paid by A Co on C Co's profits would not be allocated to C Co. The June 2024 Guidance considers that this result could lead to double taxation if top-up taxes are payable with respect to C Co, and could also inflate the ETR for Jurisdiction A if the tax is included in its ETR calculation (rather than being allocated to C Co).

Instead, the June 2024 Guidance concludes that it is more appropriate for "owner" to include an indirect owner because, in that case, C Co would be regarded as a Hybrid Entity as a result of A Co being subject to tax on its profits. This treatment allows taxes paid by A Co on these profits to be allocated to C Co under Article 4.3.2(d), thereby preventing double taxation.

4. **Matching taxes and income where an owner is subject to tax with respect to a Reverse Hybrid Entity's income**

As indicated above, the June 2024 Guidance states that it is the tax law of the first owner in the ownership chain that is not itself a Flow-through Entity (the Reference Entity) that determines whether a Flow-through Entity is a Tax Transparent Entity or Reverse Hybrid Entity. While this rule typically ensures that profits of a Flow-through Entity are generally allocated to the jurisdiction that is expected to have primary taxing rights in respect of that income, that may not always be the case where the entity is owned via a chain of entities. That is because the jurisdictions where the owners are located could take differing views on the transparency of an entity, leading to a mismatch in the allocation of profits and taxes.

The June 2024 Guidance illustrates this concern through the following example (see June 2024 Guidance, section 5, para. 91 et seq.):



The profits of C Co will be included in A Co's taxable income and subject to tax (because Jurisdiction A's tax laws consider B Co and C Co to be transparent) and those profits are not taxed in either Jurisdiction B or C.

In this case, B Co is the Reference Entity and, because the tax laws of Jurisdiction B treat C Co as opaque, C Co is a Reverse Hybrid Entity.

The result of this treatment is that the GloBE Income of C Co is not allocated to any other Constituent Entity but the tax paid by A Co with respect to C Co's income is not allocated to C Co.

The June 2024 Guidance concludes that this result is inconsistent with the policy of matching income and taxes on C Co's income. Accordingly, the June 2024 Guidance clarifies that Covered Taxes paid by a direct or indirect owner with respect to the profits of a Reverse Hybrid Entity are allocated to the Reverse Hybrid Entity under Article 4.3.2(d) (i.e., allocated to C Co in the above example).

As a coda to the above, we note that the June 2024 Guidance confirms that a jurisdiction that does not have a generally applicable corporate income tax or similar Covered Tax cannot treat an entity created in the jurisdiction or an entity owned by an entity created in the jurisdiction as fiscally transparent. Nevertheless, an entity located in such a jurisdiction may still be treated as a Tax Transparent Entity in certain circumstances pursuant to Article 10.2.4. See June 2024 Guidance, section 5, para. 28. We also note that the guidance addresses the application of the IIR under Article 3.5.3 where minority owners hold interests in a Constituent Entity via a flow-through Entity. A detailed discussion of these and other points is beyond the scope of this alert.

6. June 2024 Guidance on Securitization Vehicles

The OECD has recognized that imposing top-up tax on securitization special purpose vehicles ("**SPVs**") could undermine the stated purpose of securitization transactions (namely, lowering cost of borrowing, reducing liquidity risks by transferring assets to a bankruptcy remote entity etc.). In particular, the OECD notes that the SPV having exposure to top-up tax charges elsewhere in the originator group would mean that the SPV is no longer insulated from risks associated with the originator.

Moreover, whilst the OECD states that, in general, securitization SPVs are structured such that negligible surplus cash/profits arise in the SPV, this may not always be the case, particularly where the SPV enters into hedging arrangements which may have large fair value movements.

Accordingly, the June 2024 Guidance provides that:

- QDMTT jurisdictions are not required to impose top-up tax liabilities on SPVs (so called "Securitization Entities" - see below) used in securitization transactions; instead, any QDMTT liability in respect of a securitization SPV should generally be imposed on other Constituent Entities in that jurisdiction or securitization SPVs may be excluded from the definition of Constituent Entity for the purposes of QDMTT;
- Jurisdictions that exclude Securitization Entities would apply the so-called 'switch-off rule' such that they would not benefit from the QDMTT Safe Harbor. However, if a jurisdiction's QDMTT liability in respect of a Securitization Entity is imposed on other group entities in that jurisdiction then the QDMTT Safe Harbor would still be available;
- Jurisdictions may exclude Securitization Entities from top-up taxes under the UTPR;
- Further Administrative Guidance will be issued to ensure that securitization transactions giving rise to fair value movements do not result in MNE Groups paying top-up taxes that are not commensurate with the economic profit of the Securitization Entity. This guidance may provide that Securitization Entities be treated as deconsolidated from the MNE Group and/or providing for elections to apply a realization basis.

In order to achieve the above, the June 2024 Guidance amends the Commentary to Article 10.1 (Defined Terms) to include the following:

- A new definition of securitization SPVs (so-called "Securitization Entities") be included in the commentary to Article 10.1. Broadly, this definition includes an Entity that:
  - carries out a "Securitization Arrangement" (see below);
  - grants security over its assets in favor of its creditors; and
  - pays out all cash it receives from its assets to its credits on an annual or more frequent basis, other than cash retained by the Entity as required by the arrangement for eventual distribution to equity holders and/or cash reasonably required for provisions for future payments or maintaining the creditworthiness of the Entity. Importantly, an Entity is not a Securitization Entity if the profits it retains for a given fiscal year are not "negligible" relative to the revenues of the Entity; and
- A new definition of Securitization Arrangement, which broadly includes arrangements implemented for the purpose of pooling and repackaging a portfolio of assets for investors that are not Constituent Entities of the MNE Group and limits the exposure of those investors to the risk of insolvency of an Entity holding the assets by controlling the ability of creditors to make claims against it.

The June 2024 Guidance in relation to securitization SPVs provides some helpful clarification to the application of the GloBE rules to securitization arrangements. Whilst the potential exclusion of Securitization Entities from QDMTT and UTPR will generally be welcomed by taxpayers, in practice this exclusion may not be hugely beneficial given the strict requirements on the amount of profit that a Securitization Entity can have and the potential impact on a jurisdiction's ability to apply the QDMTT Safe Harbor (leaving Securitization Vehicles potentially subject to another jurisdiction's IIR). Moreover, it is unfortunate that there will be yet another round of Administrative Guidance in relation to securitization arrangements as this further prolongs the uncertainty for these arrangements.

7. Q&A Peer Review Process

In December 2023, the Inclusive Framework announced that it would implement a robust and transparent peer review process that would focus on the qualification of local Pillar Two legislation from an OECD Pillar Two perspective. In particular, the Inclusive Framework stated that this Peer Review Process was expected to contain a transitional and permanent review process. Together with the June 2024 Guidance, the Inclusive Framework published guidance on this Peer Review Process in the form of a Q&A Document.

The key considerations can be summarized as follows:

- **Purpose:** The stated purpose of this Peer Review Process is to achieve consistency and coordinated application of the GloBE Rules across the different jurisdictions, leading to greater certainty for Pillar Two jurisdictions as well as in-scope MNE groups.
- **Approach**: The Peer Review Process seeks to determine the "qualified" status of the IIR, UTPR and QDMTT implemented in a Pillar Two jurisdiction as well as eligibility for the QDMTT Safe Harbor. From a practical perspective, it is not deemed realistic nor feasible to approach this in the form of a full legislative review of the rules implemented in each Pillar Two jurisdiction. Therefore, the Inclusive Framework developed a two step-approach:
  1) Transitional qualification mechanism under the transitional approach; and
  2) Full legislative review and ongoing monitoring by the Inclusive Framework, which we understand is the process under the permanent approach.
- **Initial transitional qualification mechanism – "Self-Certification"**
  - The transitional qualification mechanism is based on a self-certification under which the implementing jurisdictions (i.e., IIR, UTPR and/or QDMTT jurisdictions) provide information on the main features of their Pillar Two legislation to the OECD Secretariat. This information is then shared with all Inclusive Framework members, who will be able to raise questions. If no questions are raised by the Inclusive Framework members -or if their questions are resolved- the Pillar Two jurisdiction will obtain a transitional qualified status.
  - If, however, any questions from the Inclusive Framework members are not resolved, the status will depend on the following:
    - **Consensus**: If the Inclusive Framework members reach consensus and agree that the relevant Pillar Two jurisdiction does not qualify under the transitional qualified mechanism, the Pillar Two jurisdiction will not obtain the transitional qualified status. This consensus will be based on a 'consensus-minus-one approach', meaning that it will take more than one Inclusive Framework member to block such consensus.
    - **No consensus**: If on the other hand the Inclusive Framework members do not reach consensus, the Pillar Two jurisdiction will automatically obtain the transitional qualified status, though its legislation will be prioritized under the full legislative review.
  - The transitional qualified status of a Pillar Two jurisdiction is expected to be established within 12 months after the effective date of the Pillar Two legislation in that jurisdiction. Once established, it is expected to apply as from the effective date of the Pillar Two legislation.
  - The Inclusive Framework will publish a list of Pillar Two jurisdictions that have received the transitional qualified status. This list will be regularly updated by the Inclusive Framework. Pillar Two jurisdictions are required to accept the transitional qualified status.
- **The full legislative review:** According to the Q&A document the full legislative review will start no later than two years after the effective date of the Pillar Two legislation in a jurisdiction. Once the full legislative review is completed, the transitional qualified status will end accordingly. Should the full legislative review result in local legislation being "disqualified", this will not have retroactive effect.

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